Report

of the

Examination of

Mt. Morris Mutual Insurance Company

Coloma, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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Jorge Gomez, *Commissioner*

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May 24, 2004

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

MT. MORRIS MUTUAL INSURANCE COMPANY
COLOMA, WI

and this report is respectfully submitted.

I. INTRODUCTION

The previous full scope examination of Mt. Morris Mutual Insurance Company ("the company") was conducted in 1999, as of December 31, 1998. A limited scope examination of the company was conducted in 2002, as of December 31, 2001. The limited scope examination consisted of a review of the company's Schedule D investments, including the process by which the company purchases and rates its securities, and its compliance with the requirements of the NAIC's Securities Valuation Office ("SVO"). The current examination covered the period since the prior full scope compliance examination ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company

Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

The company was originally organized in 1876, as Mt. Morris Norwegian Mutual Fire Insurance Company, a town mutual insurer. It changed its name to Mt. Morris Mutual Insurance Company through subsequent amendments to its articles and bylaws. In 1997, the company filed for and was granted permission to be an assessable domestic mutual under ch. 611, Wis. Stat.

The company has been the acquiring party in a succession of mergers. The company absorbed all of the assets and assumed all of the liabilities of Aurora Mutual Fire Insurance Company, on March 31, 1983; Arkdale Mutual Fire Insurance Company, on January 1, 1990; Oakfield Mutual Insurance Company, on January 1, 1998; and Wonewoc Farmers Mutual Insurance Company, on September 1, 1999. These mergers were all with town mutual insurance companies.

The Mt. Morris Agency began operations on September 1, 2002, authorized by the Mt. Morris Mutual directors. It is incorporated and operated as a separate entity. The company obtained the WFM Agency as part of its merger with Wonewoc Farmers Mutual Insurance Company. This agency is also operated as a separate entity.

The company is licensed and writes direct premium in Wisconsin only. The major products marketed by the company include Farmowner Multiple Peril, Homeowners Multiple Peril, Commercial Multiple Peril, Allied Lines, and Fire. The major products are marketed through 235 independent agents. The company uses standard contract forms and commission schedules for its agents.

The following table is a summary of premiums written by the company in 2002. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Ceded	Net Premium
Fire	$ 451,704	$ 124,864	$ 326,840
Allied lines	677,555	187,295	490,260
Farmowners multiple peril	4,139,922	1,144,389	2,995,533
Homeowners multiple peril	2,522,499	697,289	1,825,210
Commercial multiple peril	1,028,787	284,385	744,402
Other liability - occurrence	57,677	42,892	14,785
Total All Lines	$8,878,144	$2,481,114	$6,397,030

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of 9 members. Directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. The board members currently receive a per diem of $125 per meeting and mileage reimbursement at the federal mileage schedule for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Fred J. Anderson Poy Sippi, WI	Retail	2004
Robert F. Hoefs Hillsboro, WI	Retired	2006
Howard H. Fenske Coloma, WI	Insurance Company Manager	2005
Ray D. Hutchinson Weyauwega, WI	Insurance Agent	2006
Myron W. Ehrhardt Oakfield, WI	Farmer	2006
Norm I. Weiss Wautoma, WI	Retired	2005
Gordon G. Penshorn Wonewoc, WI	Insurance Agent	2004
Robert Benish, Sr. Hillsboro, WI	Farmer	2005
Glenn Thalacker Montello, WI	Retired	2005

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2002 Compensation
Fred Anderson, Jr.	President	$ 2,500
Howard H. Fenske	Secretary and Treasurer	68,722
Robert F. Hoefs	Vice-President	3,000
Connie Weber	Vice-President, Internal Operations	26,237
Cathy Atkinson	Vice-President, Claims	30,744
Roberta Galbraith	Vice-President, Underwriting	37,564
Annabelle Fenske	Vice-President, Operations	18,599
Kathryn Voss	Vice-President, Finance	27,572

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee
Glenn Thalacker, Chair
Norm Weiss
Myron Ehrhardt

Finance Committee
Myron Ehrhardt, Chair
Robert Hoefs
Robert Benish

Marketing Committee
Ray Hutchinson, Chair
Robert Benish
Gordon Penshorn

Rate and Evaluation Committee
Norm Weiss, Chair
Gordon Penshorn
Ray Hutchinson

Personnel Committee
Robert Hoefs, Chair
Howard Fenske
Fred Anderson

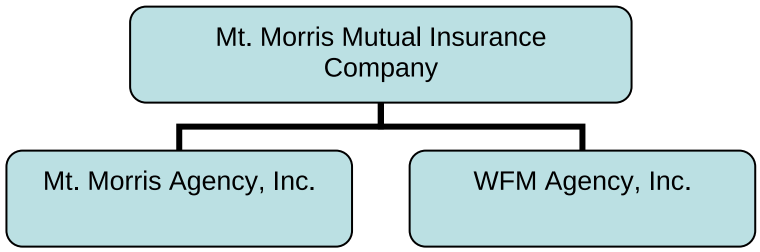
Nomination Committee
Robert Benish, Chair
Glenn Thalacker
Robert Hoefs

Auditing Committee
Glenn Thalacker, Chair
Myron Ehrhardt

IV. AFFILIATED COMPANIES

Mt. Morris Mutual Insurance Company is the ultimate parent of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates follows the organizational chart.

Organizational Chart
As of December 31, 2002



WFM Agency, Inc.

WFM Agency, Inc. (“WFM Agency”), was acquired in the merger of Mt. Morris Mutual Insurance Company and Wonewoc Farmers Mutual Insurance Company on September 1, 1999. WFM Agency is incorporated and operated as a separate entity. WFM Agency continues to hold the renewal rights associated with policies it writes.

As of December 31, 2002, the company's unaudited financial statement reported assets of $36,167, liabilities of $4,833, and net worth of $31,334. Operations for 2002 produced a net income of $17,423.

Mt. Morris Agency, Inc.

Mt. Morris Agency, Inc. (“the agency”), began operations on September 1, 2002, authorized by the Mt. Morris Mutual Insurance Company directors. The agency is incorporated and operated as a separate entity. The purpose of the agency is to provide coverage for risks that are not written by Mt. Morris Insurance Company, or that do not meet the company’s underwriting standards including automobile and life and health insurance. By placing these coverages for applicants and agents that are not provided by the company, the company is able to retain a greater portion of its profitable business from its agents and policyholders.

As of December 31, 2002, the company's unaudited financial statement reported assets of $21,415, no liabilities, and net worth of $21,415. Operations for 2002 produced a net loss of $8,440.

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

Ceding Contracts

1.	Type:	Property Per Risk Excess of Loss
	Reinsurer:	Rockford Mutual Insurance Company
	Scope:	Property Coverages
	Retention:	Coverage Part A: - $175,000 for each and every risk Coverage Part B: - $400,000 for each and every risk
	Coverage:	<u>Coverage Part A</u>: - $225,000 in excess of $175,000 for each and every loss including loss adjustment expenses. <u>Coverage Part B</u>: - $200,000 in excess of $400,000 for each and every loss, including loss adjustment expenses. Coverage Part A & B: - The Reinsurer's total limit of liability in respect to each and every risk shall be $425,000. Company maintains facultative reinsurance for risks in excess of $600,000.
	Premium:	<u>Coverage Part A</u>: 5.0% of subject net premiums <u>Coverage Part B</u>: 1.0% of subject net premiums For the initial annual period this contract is in effect, Mt. Morris Mutual shall pay to Rockford Mutual a total premium of $408,000 for Coverage Part A, $77,500 for Coverage Part B.
	Effective date:	January 1, 2003
	Termination:	As of any January 1 by either party giving 90 days' prior notice in writing by certified mail
2.	Type:	Property Annual Aggregate Excess of Loss
	Reinsurer:	Rockford Mutual Insurance Company
	Scope:	Property Coverages
	Retention:	$4,700,000 per any one calendar year period
	Coverage:	100% of the amount, if any, by which aggregate of Mt. Morris Mutual's net retained losses and loss adjustment expenses of its own account which occur during any one calendar year period of this contract exceed any amount equal to $4,700,000

	Premium:	15.0% of subject net premiums For the initial annual period this contract is in effect, Mt. Morris Mutual shall pay to Rockford Mutual a total premium of $1,095,000.
	Effective date:	January 1, 2003
	Termination:	As of any January 1 by either party giving 90 days' prior notice in writing by certified mail
3.	Type:	Liability Reinsurance
	Reinsurer:	Rockford Mutual Insurance Company
	Scope:	Business classified and written by Mt. Morris Mutual as Comprehensive Personal Liability, Farmers' Comprehensive Personal Liability, Section II of Business Owners' Liability, and General Liability
	Retention:	$25,000 for each and every loss occurrence
	Coverage:	<u>Coverage A – Liability Excess of Loss Coverage</u> Rockford Mutual shall reimburse Mt. Morris Mutual for each and every loss in excess of $25,000 of the limits exposed on all applicable liability coverages for any one occurrence <u>Liability Annual Aggregate Excess of Loss</u> 100% of the amount, if any, by which the aggregate of Mt. Morris Mutual's net retained losses and loss adjustment expenses of its own account which occur during any one calendar period of this contract exceed 20% of Mt. Morris Mutual's surplus as of the end of the contract year, or $200,000, whichever is the lesser amount
	Premium:	20% of the subject net premium for Liability Excess of Loss Coverage A (600-24) and 10% of the subject net premium for Liability Annual Aggregate Excess of Loss (600-27)
	Effective date:	January 1, 2003
	Termination:	As of any January 1 by either party giving 90 days' prior notice in writing by certified mail
4.	Type:	Winstorm Occurrence Excess of Loss
	Reinsurer:	Rockford Mutual Insurance Company
	Scope:	Windstorm and Hail Coverage (excluding Fire and other Extended Coverages)

Coverage:	Coverage A: - Rockford Mutual shall indemnify Mt. Morris Mutual 90% for any one loss occurrence that exceeds $350,000 up to a maximum 90% of $950,000 from any one occurrence. Rockford Mutual shall indemnify the Company up to a maximum of 90% of $1,900,000 from all occurrences during one calendar year.
	Coverage B: - Rockford Mutual shall indemnify Mt. Morris Mutual 95% for any one loss occurrence that exceeds $1,300,000 up to a maximum 95% of $2,700,000 from any one occurrence. Rockford Mutual shall indemnify the Company up to a maximum of 95% of $5,400,000 from all occurrences during one calendar year.
	Coverages A & B: - For each loss occurrence. Mt. Morris shall retain net for its own account an amount of losses and loss adjustment expenses equal to $350,000 per occurrence plus 10% of the next $950,000 plus 5% of the next $2,700,000.
Premium:	Mt. Morris shall pay a total deposit premium of $346,200 for Coverage A and $228,500 for Coverage B.
	Coverage A: 12.0% of subject net premiums
	Coverage B: 9.0% of subject net premiums
	Effective date: January 1, 2003
Termination:	As of any January 1 by either party giving 90 days' prior notice in writing by certified mail

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2002, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Mt. Morris Mutual Insurance Company
Assets
As of December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$2,572,219		$2,572,219
Stocks:			
Preferred stocks	937,835		937,835
Common stocks	1,735,661		1,735,661
Real estate:			
Occupied by the company	250,945		250,945
Cash	1,395,532		1,395,532
Short-term investments	100,048		100,048
Other invested assets	52,749		52,749
Receivable for securities	82,029		82,029
Premiums and agents' balances in course of collection	92,386		92,386
Premiums, agents' balances, and installments booked but deferred and not yet due	1,632,072		1,632,072
Reinsurance recoverable on loss and loss adjustment expense payments	97,682		97,682
Federal and foreign income tax recoverable and interest theron	448,548	$ 6,800	441,748
Electronic data processing equipment and software	30,020		30,020
Interest, dividends, and real estate income due and accrued	42,239		42,239
Furniture, equipment, and supplies	30,106	30,106	
Total Assets	$9,500,071	$36,906	$9,463,165

Mt. Morris Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2002

Losses	$ 913,281
Loss adjustment expenses	143,600
Commissions payable, contingent commissions, and other similar charges	528,512
Other expenses (excluding taxes, licenses, and fees)	4,202
Taxes, licenses, and fees (excluding federal and foreign income taxes)	(38,347)
Unearned premiums	4,507,384
Advance premium	216,290
Ceded reinsurance premiums payable (net of ceding commissions)	170,874
Amounts withheld or retained by company for account of others	14,096
Total Liabilities	6,459,892
Unassigned funds (surplus)	3,003,273
Total Liabilities and Surplus	$9,463,165

Mt. Morris Mutual Insurance Company
Summary of Operations
For the Year 2002

Underwriting Income		
Premiums earned		$5,733,208
Deductions:		
Losses incurred	$3,268,487	
Loss expenses incurred	329,767	
Other underwriting expenses incurred	2,275,073	
Total underwriting deductions		5,873,327
Net underwriting gain or (loss)		(140,119)
Investment Income		
Net investment income earned	219,324	
Net realized capital gains or (losses)	(245,365)	
Net investment gain or (loss)		(26,041)
Other Income		
Finance and service charges not included in premiums	128,386	
Write-ins for miscellaneous income:		
Miscellaneous Income	26	
Income from Subsidiary Agencies	8,982	
Total other income		137,394
Net income (loss) before federal and foreign income taxes		(28,766)
Federal and foreign income taxes incurred		78,445
Net Loss		$ (107,211)

Mt. Morris Mutual Insurance Company
Cash Flow
For the Year 2002

Premiums collected net of reinsurance			$6,521,917
Deduct:			
Loss and loss adjustment expenses paid (net of salvage or subrogation)			2,715,581
Underwriting expenses paid			2,208,782
Cash from underwriting			1,597,554
Net investment income			223,890
Other income (expenses):			
Net amount withheld or retained for account of others		$ 10,856	
Write-ins for miscellaneous items:			
Policy Fees		128,386	
Miscellaneous Income		26	
Total other income			139,268
Deduct:			
Federal income taxes paid (recovered)			129,519
Net cash from operations			1,831,193
Proceeds from investments sold, matured, or repaid:			
Bonds	$ 224,000		
Stocks	1,666,773		
Miscellaneous proceeds	(82,029)		
Total investment proceeds		1,808,744	
Cost of investments acquired (long-term only):			
Bonds	1,015,510		
Stocks	1,409,998		
Other invested assets	43,766		
Miscellaneous applications	187,635		
Total investments acquired		2,656,909	
Net cash from investments			(848,165)
Cash provided from financing and miscellaneous sources:			
Other cash provided		24,784	
Cash applied for financing and miscellaneous uses:			
Other applications		19,179	
Net cash from financing and miscellaneous sources			5,605

Reconciliation

Net change in cash and short-term investments	988,633
Cash and short-term investments, December 31, 2001	506,948
Cash and short-term investments, December 31, 2002	$1,495,581

Mt. Morris Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2002

Assets		$9,463,165
Less liabilities		6,459,892
Adjusted surplus		3,003,273
Annual premium:		
Lines other than accident and health	$6,397,030	
Factor	20%	
Compulsory surplus*		1,279,406
Compulsory surplus excess (or deficit)		$1,723,867
Adjusted surplus (from above)		$3,003,273
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)		1,791,168
Security surplus excess (or deficit)		$1,212,105

* The company is subject to a minimum surplus of $1,000,000 pursuant to an order by the Commissioner.

Mt. Morris Mutual Insurance Company
Reconciliation and Analysis of Surplus
For the Four-Year Period Ending December 31, 2002

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2002	2001	2000	1999
Surplus, beginning of year	$3,185,925	$2,880,316	$2,335,415	$2,520,124
Net income	(107,211)	183,723	311,527	187,197
Net unrealized capital gains or (losses)	(225,234)	(118,006)	243,315	(364,737)
Change in net deferred income tax	136,890	110,042		
Change in non-admitted assets	(1,008)	(6,978)	(9,941)	(7,169)
Cumulative effect of changes in accounting principles	13,911	136,828		
Surplus, end of year	$3,003,273	$3,185,925	$2,880,316	$2,335,415

Mt. Morris Mutual Insurance Company
Insurance Regulatory Information System
For the Four-Year Period Ending December 31, 2002

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below.

	Ratio	2002	2001	2000	1999
#1	Gross Premium to Surplus	296%	231%	198%	220%
#2	Net Premium to Surplus	213	195	176	191
#3	Change in Net Writings	3	21	16	22
#4	Surplus Aid to Surplus	0	0	0	0
#5	Two-Year Overall Operating Ratio	92	91	90	94
#6	Investment Yield	3.4*	4.3*	4.4*	4.0*
#7	Change in Surplus	3	11	23	11
#8	Liabilities to Liquid Assets	70	83	78	77
#9	Agents' Balances to Surplus	3	45*	36	39
#10	One-Year Reserve Devel. to Surplus	3	-8	-15	-1
#11	Two-Year Reserve Devel. to Surplus	-8	-14	-26	11
#12	Estimated Current Reserve Def. To Surplus	-16	10	-13	-6

The company had an exceptional ratio for Investment Yield during each year under examination and had an exceptional ratio in 2001 for Agents' Balances to Surplus.

The exceptional ratios for Investment Yield can be attributed to two factors: First, common stocks comprise 25% of the company's invested assets and they produce a low amount of dividend income. Second, the amount of investment income the company receives in rent from its two agency subsidiaries is relatively low.

The Agents' Balances to Surplus exceptional ratio in 2001 was due to the fact that the company included deferred premiums with agents' balances in course of collection. The company corrected the problem after year-end 2001 and the actual Agents' Balances to Surplus ratio for 2001 should have been 2.3%. For 2002, the company separated the amounts.

Growth of Mt. Morris Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income/(Loss)
2002	$9,463,165	$6,459,892	$3,003,273	$(107,211)
2001	8,127,013	4,941,088	3,185,925	183,723
2000	6,997,640	4,064,017	2,933,623	311,527
1999	6,472,579	4,137,164	2,335,415	187,197
1998	4,928,590	2,711,311	2,217,279	(25,965)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2002	$8,878,144	$6,397,030	$5,733,208	62.8%	35.6%	98.4%
2001	7,345,280	6,223,671	5,291,338	64.5	31.4	95.9
2000	5,798,469	5,148,641	4,859,322	62.3	35.1	97.4
1999	5,131,305	4,456,621	4,015,687	58.6	32.9	91.5
1998	4,046,858	3,641,085	3,349,187	78.7	36.5	115.2

The company's operating results have varied over the past five years. Net income has been positive in three out of the last five years. Admitted assets have increased 106% to $9.4 million, while liabilities have increased 138% to $6.4 million. Over the past five years, surplus increased 35% to $3.0 million, while gross premiums written has increased 119% to $8.8 million and net premiums written has increased 76% to $6.4 million. The company's ratio of gross written premium to surplus increased from 220% to 296%; gross leverage increased by over one-third during this period. The company has reported underwriting losses two consecutive years and three times over the last five years. The company's combined ratio averaged nearly 100% over the five year period.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2002, is accepted for the purposes of this examination.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Full Scope Examination Report Recommendations

There were 17 specific comments and recommendations in the previous full scope examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Corporate Records - It is recommended that the company comply with the filing requirements of s. Ins 6.52, Wis. Adm. Code.

   Action—Compliance

2. Corporate Records - The company should give consideration to developing a comprehensive business plan to help provide assistance as to how it will achieve its goals.

   Action—Compliance

3. Corporate Records - It is recommended that the company repeal Article VIII, Section 8.3 of their bylaws.

   Action—Compliance

4. Disaster Recovery Plan - It is recommended that the company develop a disaster recovery plan.

   Action—Compliance

5. Bonds - It is recommended that the company properly complete Schedule D, of the annual statement, following the NAIC Annual Statement Instructions.

   Action—Compliance

6. Real Estate - It is recommended that the company charge itself an amount of self-rent that produces a reasonable rate of return on their home office investment.

   Action—Compliance

7. Cash and Invested Cash - It is recommended that the company implement a petty cash system whereby an imprest amount is established, receipts are used to evidence the withdrawal of funds and replenishment of the fund is based on prenumbered receipts.

   Action—Compliance

8. Cash and Invested Cash - It is recommended that the company follow its claim payment procedure of requiring two signatures on claim checks over $10,000.

   Action—Compliance

9. Cash and Invested Cash - It is suggested that the company reconsider which personnel are authorized to be check-signers.

   Action—Compliance

10. <u>Cash and Invested Cash</u> - It is suggested that the company have separate checking accounts for claim payment and general expenses or that they require an individual to sign out check stock that they have removed from inventory.

    <u>Action</u>—Compliance

11. <u>Cash and Invested Cash</u> - It is recommended that the company reevaluates and implements more internal controls in their cash disbursement and receipt in accordance with s. 601.42 (3), Wis. Stat.

    <u>Action</u>—Compliance

12. <u>Cash and Invested Cash</u> - It is suggested that the company hire a part-time or full-time staff accountant who is experienced with preparation of insurance company financial statements, the NAIC annual statement blank, and the evaluation of internal controls.

    <u>Action</u>—Compliance

13. <u>Agents' Balances or Uncollected Premiums</u> - It is recommended that the company properly nonadmit accounts receivable balances over 90 days old.

    <u>Action</u>—Compliance

14. <u>Agents' Balances or Uncollected Premiums</u> - It is recommended that the company report advance premiums according to the NAIC Annual Statement Instructions.

    <u>Action</u>—Compliance

15. <u>Agents' Balances or Uncollected Premiums</u> - It is again recommended that in the future the company include the appropriate accruals for due deferred and uncollected premium as required by the NAIC Property and Casualty Annual Statement Blank.

    <u>Action</u>—Compliance

16. <u>Agents' Balances or Uncollected Premiums</u> - It is recommended that the company produce and maintain year-end records to substantiate annual statement amounts in accordance with s. Ins 6.80 (4) (b), Wis. Adm. Code.

    <u>Action</u>—Compliance

17. <u>Loss Adjustment Expenses</u> - It is recommended that the company accurately record amounts paid for LAE for individual claims.

    <u>Action</u>—Compliance

Compliance with Prior Limited Scope Examination Report Recommendations

There were seven specific comments and recommendations in the previous limited scope examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Investments – It is recommended that when the company files amended pages to their annual statement with OCI, the company also file amended pages electronically with the NAIC.

   Action—Compliance

2. Investments - It is recommended that the company shall designate a security as "PE" only if the company has determined that the security meets all of the requirements for a "PE" rating in the SVO Manual.

   Action—Compliance

3. Investments - It is recommended that when a security is listed with a rating in the SVO database, the company shall report the SVO's designation on its annual statement and not use a PE designation for the security.

   Action—Compliance

4. Investments - It is recommended that the company review and revise its procedures related to investment acquisition, investment reporting and compliance with SVO regulations, so that the company can accurately certify its compliance with SVO regulations on annual and quarterly statements.

   Action—Compliance

5. Investments - It is suggested that the company subscribe to the Purposes and Procedures Manual of the NAIC Securities Valuation Office, so that the company personnel and service providers can be knowledgeable of SVO procedures.

   Action—Compliance

6. Investments – It is suggested that the company purchase the NAIC publication How to Comply with the Procedures of the Securities Valuation Office.

   Action—Compliance

7. Investments - It is suggested that the company subscribe to or otherwise obtain access to the SVO's Valuation of Securities CD-ROM database, so that the company has accurate information about ratings of securities.

   Action—Compliance

Summary of Current Examination Results

Fidelity Bond Coverage

The review of the fidelity bond coverage revealed that the company currently has coverage up to $155,000. The suggested minimum amount of fidelity insurance under guidelines published by the National Association of Insurance Commissioners (NAIC) in the NAIC Financial Condition Examiners' Handbook for a company of its size, on a stand-alone basis, ranges from $175,000 to $200,000. It is suggested that the company maintain adequate levels of fidelity bond coverage for the employees responsible for the safeguard of assets in compliance with NAIC standards.

Affiliated Agreements

The review of the affiliated agreements revealed that the company charges WFM Agency, Inc., $500 per month and Mt. Morris Agency, Inc., $250 per month for the use of its buildings. The company, however, does not have a formal written lease agreement with either tenant. It is recommended that the company execute written lease agreements with Mt. Morris Agency, Inc., and WFM Agency, Inc.

Holding Company Report

During the period under review, the company did not properly file a Holding Company Annual Registration Statement (Form B and Form C) pursuant to s. Ins 40.03, Wis. Adm. Code. This filing is required annually if the company is a member of an insurance holding company system. It is recommended that the company properly file a Holding Company Annual Registration Statement, pursuant to s. Ins 40.03, Wis. Adm. Code.

Investment Exceptions

The company's Schedule D included several securities with the Securities Valuation Office (SVO) designation prefix of "RP" (redeemable preferred). It was found that two preferred stock issues did not have prospectuses to support the SVO designation prefix of "RP." It is recommended that the company maintain adequate documentation whereby justification for the rating assigned to the investment can be ascertained.

Investment Safeguards

The review of the company's investments revealed that securities are either held under a safekeeping agreement or kept in a safety deposit box. It was discovered that one of the bond holdings was accidentally filed in an unsecured file cabinet located at the company. It is recommended that the company adequately safeguard its securities.

Short-Term Investment Schedule

The company did not complete Schedule DA – Part 1 in the annual statement. Schedule DA – Part 1 should include all investments whose maturities at the time of acquisition were one year or less, except those defined as cash in accordance with SSAP No. 2. The company holds investments that meet the above criteria. It is recommended that the company complete Schedule DA – Part 1 in accordance with the NAIC <u>Annual Statement Instructions-Property & Casualty.</u>

Affiliated Stock

The company owns 100% of the outstanding shares of common stock in both Mt. Morris Agency, Inc., and WFM Agency, Inc., as noted in the area captioned "Affiliated Companies." It was found that the company did not properly report them in Schedule D – Part 2 – Section 2 as affiliated common stock, but rather reported them under Schedule BA as a long-term invested asset. It is recommended that the company report its investment in affiliates in accordance with NAIC <u>Annual Statement Instructions-Property & Casualty</u>.

Advance Premiums

The review of the items reported as advance premiums found that some of them were premium payments that were received for installment premiums rather than for anniversary premiums. Advance premiums occur when payments are received prior to the anniversary date of the policy. For example, a payment for a policy with a January anniversary date received in December would be classified as an advanced premium as of month-end December. If a policyholder makes a payment in December for an installment premium that is due in January, this payment should reduce the asset for deferred installments, not increase the liability for advance premiums. This problem appears to be a consequence of the design of the company's accounting software, not the company's internal processes or staff training. It is recommended that the company properly record advance premiums in accordance with SSAP 53, paragraph 13, and work with its software vendor, as necessary, to fix the problem.

Premium System

The review of the premium in-force/unearned premium report found that any policies that had an anniversary date within 70 days subsequent to year-end were reported at the new billed premium amount rather than the current in-force premium amount. This is because the company bills and enters new premiums into the system 60 to 70 days prior to the anniversary date of the policy, and it appears the accounting software does not properly track the current premium and the future billed amount. This problem required the company's auditors, with the help of company personnel, to make manual adjustments to written premium, deferred premium, and unearned premium in order to get to the proper annual statement balances. The balances reported by the company for these accounts were found to be materially correct. This was rather time consuming and inefficient for the company's staff and the company's auditors. It is suggested that the company work with its software vendor to fix this problem so that the premium accounting system accurately produces premium in-force/unearned premium reports.

The premium in-force/unearned premium report also included policies that had zero balances for unearned premium. Further investigation noted that these policies actually should have reported positive unearned balances. These policies all had their final installments due on December 31, 2002, and had been received. Apparently, when the accounting software reduces the premium receivable from the policyholder to zero, it also reduces the unearned premium reserve to zero, if the final installment was due on December 31 (the date the unearned premium report would be run), but not if the final installment was due on any other date. This only affected a small number of policies and the dollar impact was determined to be immaterial for purposes of this examination. It is recommended that the company properly record unearned premiums in accordance with SSAP 53, paragraph 7, and work with its software vendor to fix the problem.

The review of the premiums in-course of collection report revealed that the premium system overrides the due date of an installment premium with the due date of an endorsement. If an endorsement is made to a policy that has a premium installment due date prior to year-end, but hasn't been collected, the system automatically changes the due date of the current amount due (installment premium plus the added endorsement premium) to the endorsement due date (which is 20 days after the endorsement is made). For example: assume a policy with an installment premium due date of December 22, 2002, for which the premium had not been received prior to year-end, had an endorsement made to the policy on December 31, 2002. The software would report the installment plus the endorsement as both due on January 21, 2003. The reported year-end balance for premiums in-course of collection was correct, but the current system causes company personnel to make a number of manual adjustments on the system, which is very time consuming and inefficient. It is suggested that the company work with its software vendor to fix the problem noted with the due date of installment and endorsement premiums.

Jurat Page

The review of the company's annual statement revealed that only two individuals had signed the jurat page. According to s. 611.12(3), Wis. Stat., three separate persons holding principal offices must sign the jurat page. It is recommended that the company have three separate individuals sign the jurat page in accordance with s. 611.12(3), Wis. Stat.

VIII. CONCLUSION

The current examination of Mt. Morris Mutual Insurance Company resulted in no adjustments to surplus and no reclassifications. It resulted in eight recommendations and three suggestions. The recommendations and suggestions related to the company's amount of fidelity bond coverage, affiliated agreements, holding company report, investments, advance premiums, and the premium accounting system. The company was in compliance with all of the recommendations and suggestions made on the previous examination.

The company's operating results have varied over the past five years. Net income has been positive in three out of the last five years. It has experienced increases in premium volume, assets and surplus, but has also experienced significant increases in liabilities. The company has reported underwriting losses two consecutive years and three times over the last five years.

The company needs to significantly improve its premium accounting system. Several errors were noted with the company's in-force/unearned report resulting in the company's auditors, with the help of company personnel, to make manual adjustments to written premium, deferred premium and unearned premium, in order to get to the proper annual statement balances. In addition, the company's in-course of collection report has trouble distinguishing the due date of installment premiums and due date of endorsements. Due to the company's current size and history of significant growth, these reports need to be more accurate.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 26 - Fidelity Bond Coverage – It is suggested that the company maintain adequate levels of fidelity bond coverage for the employees responsible for the safeguard of assets in compliance with NAIC standards.

2. Page 26 - Affiliated Agreements – It is recommended that the company execute written lease agreements with Mt. Morris Agency, Inc., and WFM Agency, Inc.

3. Page 26 - Holding Company Report – It is recommended that the company properly file a Holding Company Annual Registration Statement, pursuant to s. Ins 40.03, Wis. Adm. Code

4. Page 26 - Investment Exceptions – It is recommended that the company maintain adequate documentation whereby justification for the rating assigned to the investment can be ascertained.

5. Page 27 - Investment Safeguards – It is recommended that the company adequately safeguard their securities.

6. Page 27 - Short-Term Investment Schedule – It is recommended that the company complete Schedule DA – Part 1 in accordance with the NAIC Annual Statement Instructions-Property & Casualty.

7. Page 27 - Affiliated Stock – It is recommended that the company report its investment in affiliates in accordance with NAIC Annual Statement Instructions-Property & Casualty.

8. Page 28 - Advance Premium – It is recommended that the company properly record advance premiums in accordance with SSAP 53, paragraph 13, and work with its software vendor as necessary to fix the problem.

9. Page 28 - Premium System – It is suggested that the company work with its software vendor to fix this problem so that the premium accounting system will produce an accurate premium in-force/unearned premium report.

10. Page 28 - Premium System – It is recommended that the company properly record unearned premiums in accordance with SSAP 53, paragraph 7, and work with its software vendor to fix the problem.

11. Page 29 - Premium System – It is suggested that the company work with its software vendor to fix the problem noted with the due date of installment and endorsement premiums

12. Page 29 - Jurat Page - It is recommended that the company have three separate individuals sign the jurat page in accordance with s. 611.12(3), Wis. Stat.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	**Title**
John Litweiler	Financial Insurance Examiner

Respectfully submitted,

Rick Anderson
Examiner-in-Charge

XI. Appendix – Subsequent Events

Effective July 1, 2003, the company implemented a change in billing procedure, where the company would no longer permit payment on an installment basis; instead, the invoice stated that the policy period would equal the payment mode. (An installment basis allows policyholders to pay premiums on a periodic basis rather than in full at the inception of the contract.) For example, if a policyholder wanted to make quarterly payments on a policy that was previously for a 12 month term, the policyholder would have a policy period of only three months (the policy term equal to the payment mode). The company believes that shorter policy periods allow greater flexibility in implementing rate changes and in nonrenewing policies.

During the implementation of this new procedure, the company failed to provide 60 days advance notice at renewal regarding this change to the policy term, as required by s. 631.36 (5), Wis. Stat. In order to comply with s. 631.36, Wis. Stat., for every instance in which proper notice was not given at renewal, the company had to reform the policy to the previous 12-month policy period. In addition, the company implemented a rate increase on August 21, 2003, and applied the rate increase to those policyholders with renewal dates after July 1 who paid on the installment basis. Since those policies were reformed to a 12-month duration, the rate increases were not appropriate, so the company had to refund (or credit) the additional premium amount.

The company began to give proper notice to policyholders about the change in terms (policy period) at renewal on or about December 18, 2003, for renewal dates after February 18, 2004.

On May 24, 2004, this examination conducted an additional review to determine whether the company had properly calculated and refunded midterm rate increases applied to policies that were still on a 12-month duration (due to lack of proper notice of altered terms), i.e., those with renewal dates of July 1 to August 21, 2003. The review indicated that the company appeared to have properly refunded premium for the majority of both current policyholders as well as policyholders that were no longer with the company. As a result of this review, the company refunded additional premium to two policy holders where the refund had not been properly calculated by the company.

Effective in 2004, the company filed for and was granted permission to be a nonassessable domestic mutual under ch. 611, Wis. Stat. The company is required to maintain a permanent surplus of $2,000,000 and is allowed to retain a maximum aggregate liability on non-property coverage of $600,000.